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Report of the Expert Group on Trade Financing Mechanisms in and among Developing Countries

Geneva, 11-12 July 1991

Report by the UNCTAD Secretariat

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I. ORGANIZATIONAL MATTERS

(a) Opening of the meeting

(Agenda item 1)

1. The Ad Hoc Expert Group Meeting on Trade Financing Mechanisms in and among Developing Countries was opened on 11 July 1991 by the Deputy to the Secretary-General of UNCTAD and Director of the Commodities Division, Mr. Carlos FORTIN, who made an introductory statement (paras. 6-7).

(b) Election of officers

(Agenda item 2)

2. At its first meeting, on 11 July 1991, the Ad Hoc Expert Group elected the following officers to serve on its bureau:

Chairman:	Mr. Kalyan BANERJI (India)
Vice-Chairmen:	Mr. T. OZKAN (Turkey) and Mr. John HALL (United Kingdom)
Rapporteur:	Mr. Noel L. BENNETT (Jamaica)

(c) Adoption of the agenda and organization of work

(Agenda item 3)

3. At the same meeting, the Ad Hoc Expert Group adopted the provisional agenda for its session as follows:

1. Opening statement by the representative of the Secretary-General of UNCTAD.
2. Election of officers.
3. Adoption of the agenda and organization of work.
4. Review of trade financing facilities in developing countries.
5. Review of the feasibility study on the Interregional Trade Financing Facility.
6. Other business.
7. Adoption of the report of the Ad Hoc Expert Group Meeting.

4. With regard to its organization of work, the Ad Hoc Expert Group Meeting agreed to discuss items 4 and 5 in an informal working group, to allow for a free-ranging discussion of the issues and a direct exchange of views with participants who had been actively involved in the issues of trade finance.

(d) Attendance

5. The participants in the meeting included experts from 20 national export-import, finance or insurance institutions or banks, as well as representatives of the Asian Development Bank and the Geneva and New York chapters of the Group of 77. The list of participants is annexed.

II. DISCUSSION

Review of trade financing facilities in developing countries

(Agenda item 4)

6. In his opening statement, Mr. Carlos FORTIN, Deputy to the Secretary-General of UNCTAD, welcomed the experts and explained the background to the Ad hoc Expert Group Meeting on the issue of trade financing in developing countries. He also reminded the experts of the various forums in which the issue of trade financing in developing countries has been discussed since 1981.

7. Turning to the substantive issues, he then introduced the three main documents presented to the expert group meeting (UNCTAD/Misc.87, 88 and 89). He also drew attention to the conclusion emerging from these studies: that developing countries had manifestly an important problem regarding trade finance and that this problem reflected both a functional gap and institutional underdevelopment. He added that if developing countries' efforts to liberalize and extend their trade were to succeed, they would have to solve the difficulties they faced, especially in regard to non-traditional exports. In this connection, he pointed out that developing countries ought to do everything possible to promote trade financing not only individually, but also through collective efforts. The idea of an interregional trade financing facility would undoubtedly be a focal point in developing country cooperation in the coming years and a yardstick by which international cooperation among the North and the South would be measured.

8. The representative of the UNCTAD secretariat then made a statement in which he reviewed the main analytical issues raised in the three studies. He summarized not only the principal reasons for the inadequacy of trade finance in developing countries but also the conclusions and the recommendations reached in the reports. He then called upon the experts to critically evaluate the studies by looking at both the institutional and the functional gaps in developing countries' trade finance, at national and regional levels, as well as to address the issue of what constituted traditional or non-traditional products.

9. During the discussion which followed, some experts expressed the view that, for the least developed countries, the problem of the availability of trade credits was a major constraint for the export sector at all levels; that is at both pre-shipment and post-shipment stages as well as for short-term and long-term finance.

10. The view was expressed that in some indebted countries, capital flight presented serious problems for internal stability. A policy aimed at reducing capital flight would undoubtedly make more funds available for domestic use, including trade finance. Some experts reported that, at least in the case of exports of primary commodities and minerals, there was no requirement for additional finance. All exports of such commodities were automatically funded, as they required mainly self-liquidating credits.

11. One expert stated that exports should be viewed in the context of the overall export cycle which spanned across the first stage of the production process to the final stage of shipment. Finance was required at all stages and not only at the final stage of exports. Furthermore, for some African countries, finance at the production stage was essential and this presented a major bottleneck in the development of exports. It was also stated that pre-shipment finance was the major factor determining growth of exports in the early stages of development, as the experience of the more advanced developing countries of South-East Asia had shown.

12. For most countries which had reached a relatively high degree of industrialization, with exports that were well-established and profitable, it was felt that the need for trade finance was mostly limited to long-term, post-shipment finance and to ensuring that domestic banks and institutions made prompt, quick and direct credit disbursements to exporters.

13. It was also reported that, given the varied levels of economic development among developing countries, the degree and level of development were the major factors determining the type and level of financial needs of each country. In this connection, the poorer the country and the lower the degree of industrialization, the greater the need for direct support from Governments in the form of subsidies. However, for countries with major financial constraints, external funding was the only possibility for eliminating this bottleneck, thereby meeting their trade financing needs. In this connection, one expert added that he felt that there was an urgent need to strengthen domestic financial institutions which directly supported manufacturers' exports, so as to create income and employment as a by-product of export promotion. In the longer run, as countries developed and their export sector became established and financially viable, the need for direct support would lessen, as they would be able to stand on their own. Indirect support, however, would still be required in the form of marketing, information, etc.

14. One expert pointed out that in the case of a middle-income country with strong export performance, the only problems facing exporters concerned exports to other developing countries. These related to both short-term - long-term and pre-shipment - post-shipment credits, particularly for the small and medium-sized manufacturer/exporter. This, he said, might explain why the bulk of exports from the newly industrializing countries (NICs) and new NICs were being shipped mainly to developed countries.

15. Several experts also expressed the view that insurance and guarantee schemes played an important role in mobilizing trade credits. In the case of bank lending, the provision of insurance or guarantees would greatly encourage banks to lend more money for both pre-shipment and post-shipment exports. Such facilities could be established at both national and international levels. An analogy was drawn in this regard to the recent cooperation programme between the Bern Union and the World Bank in providing bigger cover for credit-worthy countries.

16. It was stated that, with the exception of the Inter-American Development Bank and the Islamic Development Bank, no concerted efforts had been made on the part of regional development banks to support directly the exports of developing countries.

17. Furthermore, as regards Bladex, most experts saw it simply as a part of the network of correspondent commercial banks and not devoted specifically to the promotion and development of exports per se.

18. On the issue of the definition of non-traditional exports, the experts felt that this depended very much on the country concerned but that, in general, non-traditional exports were those resulting from new production patterns as opposed to old ones. They could not be defined in terms of primary commodities, manufactures, etc.

Review of the feasibility study on the Interregional Trade Financing Facility

(Agenda item 5)

19. Mr. Paul Sacks, representing the consultancy firm which had prepared the study, made a presentation outlining the main features of the institution and the various scenarios for its resources and lending capacity.

20. The discussion on the feasibility study of an interregional trade financing facility (ITFF) centred on a number of issues relating both to (i) the viability of the institution under the various envisaged scenarios as well as (ii) its ability to meet the financial and development needs of export expansion by developing countries.

(i) Viability

21. A statement was made by one expert regarding the financial viability and profitability of the proposed ITFF. In particular, he said that, in his view, the proposal was rather optimistic in its assumptions regarding the leverage ratio of 1:5, that the estimates of overhead costs were low in relation to the volume of projected business and that provisions against loan losses were inadequate. He believed that this might explain why the proposed facility was projected to be profitable even under the most unfavourable scenario.

22. On a related issue, some experts expressed scepticism concerning the proposed guarantees to be provided by the central banks and wondered whether they were sufficient to give the ITFF adequate financial backing in order for it to command credibility and good standing in international financial markets and therefore raise funds in sufficient amounts and on competitive terms.

23. Another expert drew the meeting's attention to the fact that if the facility was entrusted with the financing not only of export transactions but also of the investments required for the production and manufacture of goods, then an entirely different approach to assuring its viability would be required. He said that the market perception of such an institution, and therefore its ability to raise funds, hinged closely on its lending activities. In his view, the facility should limit itself to export financing.

(ii) Ability to meet financial and development needs

24. As regards the various scenarios presented in the feasibility study, a proposal was made that the "problem case" scenario should be revised to become the basic scenario, as it was the most realistic model of the situation facing the developing countries. In particular, it would meet their needs for medium- and short-term finance and provision of credit to all classes of borrowers.

25. It was argued by some experts that such an approach would give the facility a development dimension which it lacked in its present form. Other participants, however, felt that despite the fact that there was no explicit mention of the development aspect, the institution was clearly designed to meet, inter alia, this objective. This was so because of the relatively low spreads over LIBOR*, the collective responsibility for losses by guarantors and the envisaged gradual shifting of assets from short- to long-term credit.

26. A statement was also made regarding the inherent contradiction in the fact that the proposed facility was projected to operate by offering credits at spreads over LIBOR which were much higher than the rates offered on the Bond markets to the large borrowing countries defined in Class A. This would obviously mean that these countries would have no use for such an institution. Likewise, some experts questioned the criteria used in the definition of the various classes and pointed out that the main scenario, by which the facility would lend only to Class A countries, was neither practical nor politically feasible.

27. Drawing on the experience of a successful case from the NICs, one expert recommended that, for the institution to enhance its viability and standing in international capital markets, the facility should also finance exports of developing countries to the North; that it should adopt a more advanced approach to the mismatching of assets and liabilities in terms of currencies and interest rates; that the proportion of medium-term finance to short-term finance should take into account the structure of export of each country; and that the institution's access to the a forfait market should not lead it to ignore the potential gains to be made from interest differentials.

28. A lengthy discussion took place regarding the operational aspects of the proposed ITFF. A number of questions were raised regarding inter alia: (i) the costs of credits; (ii) the various financial instruments for the exchange rate covers, interest differentials, forfaiting and factoring; (iii) the relationship between the ITFF and the focal points, as well as (iv) efficient and modern management techniques. Although a number of suggestions were made by experts on all of the above-mentioned points, a

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* London interbank offered rate.

consensus emerged from the discussion that it would be premature at this stage to address these issues. It was agreed that the question of feasibility should be distinguished from that of the viability of the institution. As regards the former, the experts agreed that there was a strong need for trade finance for the non-traditional exports of developing countries both for pre- and post-shipment and that even in the case of the NICs, the facility would provide additional resources at relatively low cost.

29. It was also agreed that the studies prepared for the meeting demonstrated that such a facility would be sound and feasible. However, as regards its viability, it was suggested that the study should be revised so as to merge various scenarios and include a more pessimistic scenario in order to test its theoretical viability. The real test, however, would rest with the marketplace.

III. SUMMARY AND RECOMMENDATIONS

30. The experts considered the three documents prepared by UNCTAD, (UNCTAD/ECDC/Misc.87, 88 and 89) and discussed at length the technical and substantive issues raised. They commended the quality of the documents. They recognized that the documents reflected an appreciation of the problems of developing countries and made a realistic assessment of the possibilities of creating a commercially viable International Trade Financing Facility (ITFF). In the light of their experience, and as a result of their discussions, they made the following summation and recommendations:

(1) The experts believe that many developing country exporters suffer an acute paucity of foreign-exchange resources for trade financing. They are of the opinion that this paucity of credit exists for all classes of exports, especially non-traditional exports for a wide range of developing countries at different stages of development.

(2) The experts believe that it would not be advisable at this juncture to draw sharp distinctions between traditional and non-traditional exports. It is their judgement that even traditional exporters may need in present markets more than short-term credit to meet their pre- and post-shipment requirements. They also concur that the difficulties and paucity of foreign-exchange resources are particularly acute in pre-shipment credit and for non-traditional exporters to other developing countries. As non-traditional exports are estimated to grow fast, the demand for foreign-exchange resources to find imported inputs is likely to increase and represent a major barrier to increasing exports.

(3) The experts concur with the findings of the Secretariat that the financial infrastructure of most developing countries suffers from several gaps: in the majority of developing countries there are institutional and functional gaps; there is also a dearth of foreign-exchange resources. In this respect, they believe that developing countries should be encouraged to address these gaps by, inter alia, simplifying the administrative procedures, shortening the time of processing credit applications and, to the extent possible, increasing the resources made available to trade-finance institutions. They also concur that appropriate policies for export promotion should be pursued by developing countries together with a supportive macroeconomic environment. However, the experts believe that there are obvious limits to developing country resources and that the needs and gaps identified by the Secretariat cannot all be answered by domestic action alone. Accordingly, they find real merit in the idea of an International Trade Financing Facility (ITFF) conceived as complementary to national institutions and initiatives.

(4) The experts believe that the increasing liberalization in the developing economies and their increasing emphasis on promoting exports and furthering participation in world trade would be enhanced and underpinned by an international facility.

(5) The experts believe that a facility which finances and refinances in foreign exchange developing country exports can be commercially feasible. Such a facility should initially concentrate its activities on short-term credit and increase gradually its medium-term credit and it should have design characteristics which assure that it will fulfil its targeted volume of trade financing and maintain the quality of its portfolio. It is their opinion that such a facility would bring financial additionality, pool risks, provide credit and trade information and secure economies of scale and cost advantages. The experts believe that in order to fulfil these objectives, a broadly based shareholding population would be highly desirable. They strongly believe that the initiative for launching this facility must come from the developing countries and their institutions, public and private. However, the participation of developed countries and their institutions, public and private, and the appropriate multilateral funding institutions would be crucial for its success and market credibility.

(6) The experts believe that all participating developing countries would benefit from such an ITFF: the most credit-worthy developing countries would have an additional source of finance without increasing their exposure in credit markets and information gains would accrue, while developing countries of lesser credit standing would have obvious financial access to foreign-exchange resources and additionality and gain from association with the ITFF.

(7) The experts believe that both international banks and participating developed countries would also benefit from an ITFF which can serve as a credit enhancement mechanism for taking trade-credit risk for developing countries. The ITFF would have a favourable impact on trade with the developed countries and because of its wholesale credit operations in the financial markets, favourable cost advantages would accrue to the international commercial banks.

(8) The experts reviewed the technical and financial feasibility of the proposal submitted by UNCTAD. They recommend, in particular, that the base-case scenario be further refined and that, upon a formal decision being taken to establish an ITFF, further technical refinements of the proposal should be made in the light of the proceedings of the meeting.

(9) They recognize in particular, that the function of an ITFF is extremely important for developing countries. However, its institutional framework requires further refinement so as to strengthen complementarities with existing agencies and avoid duplication.

(10) The experts recommend broadening the range of substantive consultations on the ITFF to include the multilateral financial institutions and the secretariat of the Organisation for Economic Co-operation and Development, so as to ensure the complementarity of the ITFF concept with their respective mandates.

Annex

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